UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

MARK NEWBY, Plaintiff, vs. ENRON CORPORATION, et al., Defendants.	Lead Case: Civil Action No. H-01-3624
This document relates to: ALL CONSOLIDATED SECURITIES SUITS	

NOTICE OF MOTION AND MOTION TO APPOINT JMG/TQA AS LEAD PLAINTIFF FOR THE DEBT SECURITIES CLASS AND TO APPROVE ITS SELECTION OF COUNSEL AS LEAD COUNSEL FOR THE DEBT SECURITIES CLASS

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TO ALL PARTIES AND THEIR COUNSEL OF RECORD:

PLEASE TAKE NOTICE that JMG Capital Partners, L.P., JMG Triton Offshore Fund, Ltd., TQA Master Fund, Ltd., and TQA Master Plus Fund, Ltd. (collectively, "JMG/TQA") hereby move before the Honorable Lee H. Rosenthal, United States Courthouse, 515 Rusk Avenue, Courtroom 11-B, Houston, Texas for: (i) appointment as Lead Plaintiffs representing purchasers of Enron Corporation ("Enron") debt securities; and (ii) approval of Gold Bennett Cera & Sidener LLP ("GBC&S") as Lead Counsel for the debt securities class.

This motion is based on this Notice of Motion, the following memorandum of points and authorities, the Declaration of Paul F. Bennett ("Bennett Declaration"), all papers and pleadings on file in these consolidated actions, and such other evidence as the Court may consider.

This motion is made pursuant to pursuant to 15 U.S.C. §78u-4(a)(3)(B) on grounds that JMG/TQA is the most adequate plaintiff to serve as the representative of the debt securities class. As used herein, the debt securities class includes purchasers of the following Enron debt securities:

(i) $250 million in 6.95% notes pursuant to a Prospectus Supplement dated 11/24/1998;

(ii) $500 million in 7.375% notes pursuant to a Prospectus dated 5/19/1999;

(iii) $10 million exchangeable notes at $22.25 per note pursuant to a Prospectus dated 8/10/1999;

(iv) $500 million in medium term notes pursuant to a Prospectus Supplement dated 5/18/2000;

(v) $325 million in 7.875% notes pursuant to a Prospectus Supplement dated 6/1/2000; and

(vi) over $1 billion of zero coupon convertible senior notes.

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

JMG/TQA submits this memorandum in support of its motion to: (i) appoint JMG Capital Partners, L.P., JMG Triton Offshore Fund, Ltd., TQA Master Fund, Ltd., and TQA Master Plus Fund, Ltd. as Lead Plaintiffs representing the purchasers of Enron debt securities; and (ii) to confirm JMG/TQA's selection of GBC&S as Lead Counsel for the debt securities class.

JMG/TQA has suffered losses of approximately $5.1 million[1/] in connection with their purchases of Enron debt securities during the class period. In response to a notice announcing the commencement of this litigation, JMG/TQA now seek to be appointed Lead Plaintiff for the debt securities class. Because of the magnitude of their losses and their distinction as institutional investors, JMG/TQA believe that they have "the largest financial interest" in the relief sought by members of the debt securities class and, thus, are best suited to serve as Lead Plaintiff for the debt securities class.

The purchasers of Enron debt securities need representation separate from that of the purchasers of Enron equity securities. Enron filed a petition for Chapter 11 bankruptcy protection on December 2, 2001. Under the Bankruptcy Code, debt securities and claims arising

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1/ JMG/TQA purchased and sold all their Enron debt securities after the commencement of the class period. Thus, its losses were calculated by subtracting the price at which it sold the securities from the price at which it bought them. The transactions are detailed in the Certificates of Plaintiff, which are attached as Exhibits A and B to the Bennett Declaration.

from their purchase are entitled to priority over equity claims in the bankruptcy proceedings. Thus, the purchasers of Enron debt securities have a larger and legally distinct financial interest in this litigation, making it necessary for the debt purchasers and equity purchasers to be represented separately.

JMG/TQA also seek the appointment of its counsel, GBC&S, as Lead Counsel for the debt securities class. As discussed below, GBC&S is well qualified to represent the interests of this group of investors.

II. BACKGROUND

Enron recently announced that it would restate its financial statements for the past four and a half years. Several lawsuits alleging violations of the federal securities laws were brought on behalf of purchasers of Enron securities during the three year period (the length of the statute of limitations) before Enron's improper accounting practices were publicly announced.[2/] The lawsuits allege, *inter alia*, violations of: (i) Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b)) and Rule 10b-5 promulgated thereunder (17 C.F.R. §240.10b-5); and (ii) Section 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. §78t(a)).

The lawsuits allege that defendants unlawfully issued financial statements that materially overstated Enron's financial condition. These material misstatements occurred because of, *inter alia*, Enron's failure to consolidate its financial statements with those of certain "related-party"

[2/] Several lawsuits alleging violations of other state and federal laws were also filed against Enron and certain of its officers and directors. In its December 12, 2001 Order of Consolidation, the Court grouped the cases into three categories: (i) securities suits; (ii) derivative suits; and (iii) ERISA suits. There was also one lawsuit classified as an "other suit." Through this motion, JMG/TQA seeks to serve as Lead Plaintiff for the debt securities purchasers in the securities suits.

partnerships. These partnerships were operated and controlled by senior Enron officers. The failure to properly consolidate the financial results enabled Enron to keep approximately a half billion dollars in debt hidden from investors.

Defendant Arthur Andersen LLP, Enron's outside public accounting firm, condoned the accounting violations by improperly issuing unqualified audit opinions on Enron's financial statements for fiscal years 1997, 1998, 1999, and 2000 and by falsely representing that its audits had been conducted in accordance with generally accepted accounting principles.

The first of several complaints against Enron and certain of its officers and directors was filed on October 22, 2001. That same day, a notice of the commencement of the litigation was published. *See* Bennett Declaration, Exhibit C. The Securities Exchange Act of 1934, as amended, requires that such a notice be published to inform class members of their right to move to be appointed Lead Plaintiff. *See* 15 U.S.C. §78u-4(a)(3)(A)(i). Motions to serve as Lead Plaintiff must be filed within 60 days of the publication of the notice (*id.*), making the deadline herein December 21, 2001.

III. ARGUMENT

A. Notice Was Properly Published Under The PSLRA

On December 22, 1995, Congress enacted the Private Securities Litigation Reform Act ("PSLRA"). The PSLRA amended the Securities Exchange Act of 1934 to set forth procedures for notifying class members that they may move to serve as the Lead Plaintiff in the litigation. It provides that within twenty (20) days after a securities class action is filed:

> [T]he plaintiff or plaintiffs shall cause to be published, in a widely circulated national business-oriented publication or wire service, a notice advising members of the purported plaintiff class – (I) of the

> pendency of the action, the claims asserted therein, and the purported class period; and (II) that, not later than 60 days after the date on which the notice is published, any member of the purported class may move the court to serve as lead plaintiff of the purported class.

15 U.S.C. §78u-4(a)(3)(A)(i).

On October 22, 2001, the first of several securities fraud actions against Enron was filed in this Court. That same day, counsel in the first-filed action published a notice of the pendency of the action. Bennett Declaration, ¶3 and Ex. B. The notice was disseminated by PR Newswire – a widely circulated, national, business-oriented wire service. *Id.* The notice was also distributed over the Internet. *Id.* As required by the PSLRA, the notice advised members of the proposed class that they may move the Court to serve as Lead Plaintiff within sixty (60) days after the publication of that notice, *i.e.*, no later than December 21, 2001. *Id.*

B. JMG/TQA Is The "Most Adequate Plaintiff" And Should Be Appointed Lead Plaintiff For The Debt Securities Purchasers

The PSLRA provides that this Court "shall appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members[.]" 15 U.S.C. §78u-4(a)(3)(B)(i). The statute directs the Court to adopt a rebuttable presumption that the "most adequate plaintiff" is the person or group of persons that:

> (aa) has either filed the complaint or made a motion in response to a notice . . .;
>
> (bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and
>
> (cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

15 U.S.C. §78u-4(a)(3)(B)(iii)(I). JMG/TQA readily satisfies these requirements and, accordingly, should be appointed Lead Plaintiff for the debt securities class.

1. JMG/TQA Filed This Motion In Response To The Properly Published Notice

As discussed above, the notice of pendency of this action was properly published on October 22, 2001, making the deadline for moving to serve as Lead Plaintiff December 21, 2001. JMG/TQA is timely filing this motion in response to the notice.

2. JMG/TQA Has The Largest Financial Interest In The Relief Sought By The Debt Purchaser Class

JMG/TQA is an institutional investor that suffered losses of approximately $5.1 million during the Class Period. *See* Bennett Declaration, Ex. A. Appointment of JMG/TQA as Lead Plaintiff would advance the PSLRA's goal of encouraging institutional investors with large financial stakes in the outcome to assume control over securities class actions. *Gluck v. Cellstar Corp.*, 976 F. Supp. 542, 548 (N.D. Tex. 1997) ("The legislative history of the [PSLRA] is replete with statements of Congress' desire to put control of such litigation in the hands of large, institutional investors"). Accordingly, JMG/TQA should be appointed Lead Plaintiff of the debt purchaser class.

The purchasers of Enron debt securities and Enron equity securities need separate representation. Debt securities and equity securities are fundamentally different types of investments. As explained in *Model Associates, Inc. v. U.S. Steel*, 88 F.R.D. 338 (S.D. Ohio 1980):

> Ownership of common stock creates a relationship entirely different from the ownership of debentures. A shareholder is a[n] owner; a debenture holder is a creditor. Owners seek to borrow

> money at the lowest possible rate; creditors seek the highest rate. Plaintiff asserts in general that defendant violated Section 10(b) by understating its [liabilities]. . . . The failure to disclose liabilities might improve the stated financial condition of defendant and enable it to borrow at lower interest rates. The Court expresses no opinion as to plaintiff's ability to prove misrepresentation; it does, however, hold that the interests of a stockholder under such circumstances are antagonistic to a debenture holder and since plaintiff owned only common stock, its claim is not typical of the class it seeks to represent. Such antagonism represents both a potential conflict of interest and a question of ability to render fair and adequate representation.

Id. at 339-40. Because of the inherent differences between stock and debentures, the court in *Model Associates* held that a plaintiff who purchased only common stock could not represent a class defined as including both debt and equity purchasers. *Id.* at 341.

Similarly, the court in *Simon v. Westinghouse*, 73 F.R.D. 480 (E.D. Pa. 1977) noted that purchasers of common stock had different interests than purchasers of other securities issued by the company, explaining:

> For example, the market price of debentures and preferred stock may be affected by factors unrelated to the issuing company, such as the general level of interest rates. [Citation omitted.]
>
> Because of these differences, the claims of common stock purchasers are not necessarily typical of the claims of purchasers of other securities. To the extent the claims differ, purchasers of common stock will have little or no interest in presenting evidence to support the claims of purchasers of other securities. Especially in a case as large and complicated as this one promises to be, it is important that all parts of the class be represented fully and adequately, so that all parts of the class can be bound by any judgment. . . .

Id. at 484. Because the class representatives purchased only common stock, the court in *Simon* limited the class to common stock purchasers. *Id* at 485.

The differences between the purchasers of Enron stock and debt securities are also significant under the specific facts of this case. On December 2, 2001, Enron filed a petition for Chapter 11 bankruptcy protection. The Bankruptcy Code provides that debt holders and/or debt claimants are entitled to priority over those with equity interests or equity claims. 11 U.S.C. §510(b). In other words, the purchasers of Enron equity stock will be entitled to a recovery from Enron only if and when the purchasers of Enron debt securities fully recover their losses. *Id.* Thus, the members of the debt security class have a larger and legally distinct financial interest in this litigation. This makes it necessary that the debt purchasers and equity purchasers be represented by separate Lead Plaintiffs and separate counsel in these proceedings. *See e.g., Teichler v. DSC Communications Corp.*, 1998 U.S. Dist LEXIS 16448 at *10 (N.D. Tex. 1988) (noting that a potential conflict would arise between the stockholders and debenture holders in the event of bankruptcy).

There is also an important distinction between the burden that must be satisfied by the debt securities class and the equity securities class. The debt securities class can assert claims under Section 11 of the Securities Act of 1933 (15 U.S.C. §77k). Section 11 allows purchasers of a registered security to sue when a materially false or misleading statement is included in a registration statement. Unlike a claim under §10(b), there is no need to plead or prove scienter to establish a §11 claim. *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983) ("a §10(b) plaintiff carries a heavier burden than a §11 plaintiff. Most significantly, he must prove that the defendant acted with scienter, *i.e.*, with intent to deceive, manipulate, or defraud"). For this additional reason, the debt purchaser class must have separate representation.

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3. JMG/TQA Satisfies The Requirements Of Rule 23

The final prerequisite to serving as Lead Plaintiff is that the moving party must "otherwise satisf[y] the requirements of Rule 23 of the Federal Rules of Civil Procedure." 15 U.S.C. §78u-4(a)(3)(B)(iii)(I)(cc). At this stage in the proceedings, a prima facie showing that the proposed lead plaintiff satisfies the requirements of Rule 23 is sufficient. *Greebel v. FTP Software*, 939 F. Supp. 57, 64 (D. Mass. 1996).

Rule 23(a) of the Federal Rules of Civil Procedure requires that a class representative's claims be typical of those of the class members and that the representative will fairly and adequately protect the interests of the class. Consequently, in deciding a motion to serve as Lead Plaintiff, the Court should limit its inquiry to the typicality and adequacy prongs of Rule 23(a), and defer examination of the remaining requirements until the Lead Plaintiff moves for class certification. As detailed below, JMG/TQA satisfies the typicality and adequacy requirements of Rule 23(a), thereby justifying its appointment as Lead Plaintiff.

a. The Claims Of JMG/TQA Are Typical Of The Claims Of The Class

The typicality requirement of Rule 23(a)(3) is satisfied when, as here, the named plaintiff has suffered the same or similar injuries as absent class members as a result of a common course of conduct by the defendants. *See e.g., Epstein v. MCA, Inc.*, 50 F.3d 644, 668 (9th Cir. 1995), *rev'd on other grounds sub nom., Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367 (1996); *In re Cirrus Logic Sec. Litig.*, 155 F.R.D. 654, 657 (N.D. Cal. 1994).

The claims asserted by JMG/TQA are typical of, if not identical to, the claims of the other members of the debt securities class. Questions of law and fact common to the members of the class which predominate over questions which may affect individual class members include:

(1) Whether the defendants signed registration statements that contained untrue statements of material fact or omitted to state material facts necessary to make the statements in the registration statements not misleading;

(2) Whether the prices of Enron's publicly traded debt securities were artificially inflated during the Class Period; and

(3) The extent of damage sustained by members of the debt securities class and the appropriate measure of damages.

The various complaints allege that the defendants violated the federal securities laws and related SEC regulations by publicly disseminating false and misleading statements. The complaints also allege that all members of the Class relied upon the integrity of the market in purchasing Enron debt securities. JMG/TQA similarly relied upon these representations and suffered the same type of injury as the other members of the debt purchaser class. Thus, the typicality requirement is satisfied.

b. JMG/TQA Will Fairly And Adequately Represent The Interests Of The Debt Purchaser Class

Whether a party can fairly and adequately protect the interests of the class depends on "the qualifications of counsel for the representatives, an absence of antagonism, a sharing of interests between representatives and absentees, and the unlikelihood that the suit is collusive."

In re Dalkon Shield Litig., 693 F.2d 847, 855 (9th Cir. 1982).

JMG/TQA satisfies this test. There is no actual or apparent conflict between JMG/TQA and the other members of the debt purchaser class. All debt purchasers are aligned in the common interest of recovering damages from defendants based on the alleged violations of the federal securities laws. As detailed above, JMG/TQA's claims share substantial common questions of law and fact with the members of the debt securities class, and its claims are typical of the members of the debt securities class. Further, JMG/TQA have demonstrated themselves to be advocates on behalf of the class. JMG/TQA have come forward and signed plaintiff certificates stating that they are willing to assume the responsibilities of being a class representative. Bennett Declaration, Exhibits A and B.

JMG/TQA will provide zealous leadership in the prosecution of this case. Moreover, because they have lost approximately $5.1 million, they have a strong economic interest in vigorously prosecuting this case and they are presumptively the most adequate plaintiff. 15 U.S.C. §78u-4(a)(3)(B)(iii)(I)(bb). Accordingly, JMG/TQA should be appointed Lead Plaintiff.

C. This Court Should Approve Lead Plaintiff's Selection Of Counsel As Lead Counsel For The Debt Securities Class

The PSLRA vests authority in the Lead Plaintiff to select and retain Lead Counsel, subject to approval by the Court. 15 U.S.C. §78u-4(a)(3)(B)(v). Subject to the guidance of the Lead Plaintiff, Lead Counsel will have full and complete authority for the overall prosecution of this litigation on behalf of the debt securities class. Lead Counsel will be responsible for all communications with the Court and defense counsel, the filing of all pleadings by Lead Plaintiffs

in this action, and the initiation of all discovery and all settlement negotiations on behalf of the debt securities class.

JMG/TQA's choice of counsel, GBC&S, should be approved as Lead Counsel in this litigation. For over twenty years, GBC&S has played a leading role in prosecuting securities class action cases. GBC&S, along with its local counsel, Sankey & Luck, L.L.P., have the requisite experience and resources to obtain an excellent result for the Class. The firm resume of GBC&S is attached as Exhibit D to the Bennett Declaration. Accordingly, JMG/TQA's selection of GBC&S as Lead Counsel should be approved.

IV. CONCLUSION

For all of the foregoing reasons, JMG/TQA requests that the Court appoint it as Lead Plaintiff for the purchasers of debt securities and approve its selection of GBC&S and S&L as Lead Counsel for the debt securities class.

DATED: December 20, 2001

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*1988 U.S. Dist. LEXIS 16448, **

BERNARD TEICHLER, et al, Plaintiffs, v. DSC COMMUNICATIONS CORPORATION, et al, Defendants

No. CA3-85-2005-T

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION

1988 U.S. Dist. LEXIS 16448

April 15, 1988, Decided
April 26, 1988, Filed

SUBSEQUENT HISTORY: [*1] As Corrected.

CORE TERMS: stock, class action, per share, holders, debenture, proposed class, misrepresentation, shareholders, diligence, purchaser, discovery, class representative, net income, conversation, pendent, notice, causal connection, direct proof, advice, board of directors, adequately protect, average price, predominate, stockholder, deposition, reduction, sub-class, material information, choice of law, sophisticated

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OPINIONBY: MALONEY

OPINION: CORRECTED ORDER

ROBERT B. MALONEY, UNITED STATES DISTRICT JUDGE

Before the Court comes Plaintiff's motion for class certification under Fed. R. Civ. P. 23. The motion is granted.

I. Plaintiffs' Version of Facts.

A. Parties.

Plaintiffs purchased various amounts of stock from DSC Communications Corp. ("DSC") between July 20, 1984 and October 1, 1985 (the "class period"). n1 Defendants are: (1) DSC, a Delaware corporation with its principal place of business in Richardson, Texas; (2) directors and officers of DSC n2; (3) Arthur Andersen & Co. ("Andersen"), DSC's auditors.

n1 Proposed class representatives are:

Bernard Teichler Purchased 1500 shares of DSC stock at an average price of $ 13.21 per share.

Josette Melzer Bought 500 shares of DSC stock through the exercise of warrants.

John L. McFarlane Purchased 6000 shares of DSC stock over-the-counter at an average price of $ 12.00 per share.

Seymour Salit Bought 150 shares of DSC stock at an average price of $ 25.00 per share.

Richard A. Olson Purchased 3000 shares of DSC stock during the class period at cost of $ 67,664.40.

Fred Feder Bought stock during the class period. **[*3]**

n2 The directors and officers of DSC are:

James M. Nolan Chairman of DSC's board of directors since 1981. Member audit committee. Allegedly the alter ego of DSC. DSC has allegedly entered into agreements with Nolan Consulting, Nolan's business.

James L. Donald Director, CEO, president, and treasurer of DSC since 1981. Owns over 1 million shares of DSC.

Richard Scroggins Vice-president of finance of DSC. Since 1982, the principal financial and

accounting officer and an executive officer of DSC.

Directors Paul w. Broome, John B. Toomey, Clement M. Brown, Robert S. Folsom, James P. Leake and Clifford J. Osborn are all responsible for the correctness and accuracy of DSC's periodic financial reports.

Thalia V. Crooks A director of DSC since 1981 and member of the audit committee.

Allen & Co. Investment banker for DSC, receiving monthly retainer of $ 12,500.00. Defendant Crooks is Allen's designee to the board of directors.

B. Background.

DSC makes telecommunications switching systems and autodialers and sells them to competitors of AT&T. A wholly owned subsidiary of DSC merged with Granger Associates, thereby broadening DSC's product line to include digital signal processing **[*4]** products and low density communications links for private telecommunications systems. DSC's Form 10-K stated that DSC had a significant contract with GTE Sprint. DSC's 1984 annual report showed that net earnings had increased 65% over 1984's earnings. DSC continued to publish glowing reports up to December 2, 1985. Then DSC reversed itself on several earlier representations. n3

n3 Specifically, these reversals were:

(a) For the three months ended June 30, 1984, DSC reported revenues of $ 82,806,000 (instead of revenues of $ 87,175,000 previously reported) and income of $ 8,227,000 or $ .20 per share (instead of $ 10,146,000 or $ .25 per share previously reported);

(b) For the three months ended September 30, 1984, DSC reported revenues of $ 94,469,000 (instead of revenues of $ 97,160,000 previously reported) and income of $ 15,236,000 or $ .37 per share (instead of $ 16,460,000 or $ .40 per share previously reported);

(c) For the year ended December 31, 1984, DSC reported net income per share of $ 1.08 (versus $ 1.40 as previously reported); net income of $ 43,896,000 (versus $ 57,316,000 as previously reported); and revenues of $ 319,604,000 (instead of $ 352,187,000 as previously reported). This amendment also indicated a 5.3% reduction of DSC's total assets;

(d) For the first three months of 1985, DSC reported a loss of $ 1,628,000 (versus net income of $ 17,251,000, or $ .42 per share, as previously reported), and revenues of $ 78,650,000 (instead of $ 100,514,000, as previously reported). This amendment also indicated a 13.5% reduction of DSC's total assets; and

(e) For the first six months of 1985, DSC reported a loss of $ 4,371,000 (versus net income of $ 23,717,000, or $ .58 per share, as previously reported), and revenues of $ 142,514,000 (instead of $ 183,268,000, as previously reported). This amendment also indicated a 15.4% reduction of DSC's total assets. **[*5]**

Andersen provided independent auditing and accounting services to DSC and issued unqualified opinions on DSC's 1982 and 1984 annual financial statements.

Plaintiffs sue for violations of Rule 10b-5(1), (2), and (3), fraud, and negligent misrepresentation

II. Issues Presented.

The main issue is whether Plaintiffs have satisfied the requirements of Rule 23. n4 Because there is no dispute as to number, the Court finds that the proposed class is so numerous that joinder of all members is impracticable.

n4 Rule 23. Class Actions

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action. **[*6]**

The contested issues are: (1) whether reliance is an individual question of fact that will predominate the class action; (2) whether any class or sub-class can be certified which includes convertible debenture shareholders; (3) whether the proposed class representatives are typical of the class; (4) whether Plaintiff Olson will fairly and adequately protect the interests of the class; and (5) whether pendent state claims are appropriate for class action treatment.

III. Individual Reliance.

Defendants argue that individual reliance is an issue that would preclude certification.

Reliance is an element of Plaintiffs' Rule 10b-5 action. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206 (1976). Reliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury. Wilson v. Comtech Telecommunications Corp., 648 F.2d 88, 92 n.6 (2d Cir. 1981). There is, however, more than one way to demonstrate the causal connection. Basic Inc. v. Levinson, No. 86-279, slip op. at 18 (U.S. March 7, 1988). Rather than require direct proof of reliance, the Court may apply a presumption of reliance supported by the fraud-on-the-market theory. **[*7]** Basic, at 24. n5

n5 The Court in Basic issued a plurality opinion with regard to the fraud on the market theory. Justices Blackmun, Brennan, Marshall, and Stevens joined in the plurality opinion. Justices White and O'Connor dissented. Justices Rehnquist, Scalia, and Kennedy did not participate in hearing or deciding Basic.

Briefly put:

The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore

defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . . The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.

Peil v. Speiser, 806 F.2d 1154, 1160-1161 (3d Cir. 1986).

Presumptions help courts manage cases in which direct proof is difficult. Basic, at 19-20. Direct proof in a fraud on the market case is difficult, since to produce such proof, a plaintiff must show a speculative state **[*8]** of facts. A plaintiff would have to show how he would have acted if omitted material information had been disclosed or if the misrepresentation had not been made. Requiring direct proof would place an unnecessarily unrealistic evidentiary burden on the Rule 10b-5 plaintiff who has traded on an impersonal market. Basic, at 20. Therefore, courts may apply a presumption of reliance in fraud on the market cases. Id.

This presumption is rebuttable, however. Basic, at 23. Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance. Id.

However, that the presumption is rebuttable does not preclude this Court from certifying the class.

The right of rebuttal of the "presumption" of reliance, however, does not preclude the predominance of common questions. Causation as to each class member is commonly proved more likely than not by materiality. That showing will undoubtedly be conclusive as to most of the class.

. . . .

The right to disprove causation will not render the action unmanageable. A defendant **[*9]** does not have unlimited rights to discovery against unnamed class members; the suit remains a representative one.

Blackie v. Barrack, 524 F.2d 891, 907 n.22 (9th Cir. 1975), cert. denied, 429 U.S. 816 (1976).

The last sentence quoted governs Defendants' argument that even if the fraud on the market theory applies, individualized evidence on reliance will overwhelm common questions and make a class action unmanageable. Defendants estimate that discovery on reliance alone would require 14,400 hours in depositions. n6 The Court would view an attempt to spend twenty months taking depositions as tedious, wasteful, and an abuse of discovery. More efficient discovery media are available.

n6 Defendants reach this conclusion, accepting Plaintiffs' estimate that the class consists of 4,800 shareholders, and assuming each deposition would last three hours.

This Court concludes that it is appropriate in this case to apply a presumption of reliance supported by the fraud on the market theory. Basic, at 24. Therefore, the issue of individual reliance in this case does not preclude certification.

IV. Debenture Holders.

Defendants argue that no class or sub-class can be **[*10]** certified which includes debenture holders, since none of the proposed class representatives own debentures. Defendants argue that stockholders cannot represent debenture holders.

Occasionally, the positions of stock and debenture holders may be such that they will take conflicting positions on certain issues. In such a case, the best solution is not denial or limitations of the class, but rather the creation of subclasses in the event an actual **conflict** arises. n4 Newberg on Class Actions § 22.26 (2d ed. 1985).

Defendants raise no actual **conflict** between equity holders and creditors. The only potential **conflict** they can raise would be in the event of bankruptcy. In that case, the Court could set up a sub-class pursuant to Fed. R. Civ. P. 23(c)(4)(B). Id.

Courts have, in the past, permitted shareholders to represent both shareholders and holders of debentures, see Green v. Wolf Corp., 406 F.2d 291, 295, 301 (2d Cir. 1968) cert. denied, 395 U.S. 977 (1969), n7 and convertible **debenture** holders to represent both **debenture** holders and shareholders, Handwerqer v. Ginsberg, [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 94,934 (S.D.N.Y. 1975) appeal dismissed, **[*11]** 519 F.2d 1339 (2d Cir. 1975); see Republic National Bank of Dallas v. Denton & Anderson Co., 68 F.R.D. 208, 215-216 (N.D. Tex. 1975).

n7 Green did not decide the precise issue of whether a stockholder could represent holders of convertible debentures. Green decided whether the purchaser of a security who purchased after a third prospectus could represent the purchasers of securities who purchased after a first or second prospectus. However, the Green court did permit a stockholder to represent debenture holders.

V. **Typicality** of Class Representatives.

Defendants argue that none of the class representatives is typical of the class, and that therefore none of them may serve as a class representative.

A. Unique Access -- Melzer and McFarlane.

Defendants argue that Melzer and McFarlane had "unique access" to information which destroys their typicality.

1. Facts.

Mrs. Melzer is a retired school teacher. (Dep. 131.) She apparently called DSC's president's secretary, a Miss Smith, about twelve times. (Dep. 60.) Melzer stated that she had called to determine whether she had obtained all the publicly available information concerning DSC. (Dep. 69, 73.) Melzer **[*12]** said she always felt "reassured" after speaking with Miss Smith. (Dep. 53.) There is uncontradicted testimony that Miss Smith said that there was "no particular reason" why the **stock** was doing well. (Dep. 53.) Miss Smith informed Melzer as to DSC's research and contacts with Japanese companies. (Dep. 65.) There is no evidence that such information was not already publicly available. Melzer's husband had apparently conversed with the CEO of the company and reported the conversation to his wife. (Dep. 76.) The substance of this conversation is not in evidence.

McFarlane works in a small employment agency in New York and has occasionally placed employees at DSC. (Dep. 7.) Most of McFarlane's contact with DSC has been with one field officer. (Dep. 10-16.)

2. Standard.

Defendants cite four cases to persuade the Court that Melzer and McFarlane had unique access. The treatment of this issue in Simon v. Merrill Lynch, Pierce, Fenner and Smith, Inc., 482 F.2d 880, 883 (5th Cir. 1973) is so brief as to offer no guidance on what "unique access" means. n8 The facts in Simon do not involve any plaintiff having a special opportunity to gain

information not ordinarily available to the **[*13]** public. Likewise, the facts in In re Commonwealth Oil/Tesoro Petroleum Securities Litigation, 484 F. Supp. 253, 258 (W.D. Tex. 1979) do not show that any plaintiff there had unique access. The Tesoro court merely offered dicta that "if [plaintiff] had had access to certain specialized information, defendants could challenge the adequacy of his representation or the typicality of his claim." 484 F. Supp. at 258. There is certainly no showing here that Melzer or McFarlane had specialized knowledge.

The In re Saxon Securities Litigation, Fed. Sec. L. Rep. para. 99,691 (S.D.N.Y. 1984) court held that it was "likely" that one of the proposed class representatives there, a Mrs. Salmanson, had access to information or advice not available to the general investing public. There, the plaintiff's husband was a vice-president of a brokerage firm who had spoken with the top corporate officers at Saxon to complain about a particular repurchase of stock he felt to be unfair to shareholders, to discuss unusual trading in Saxon stock March 1982, and to get some idea as to the direction Saxon was going to take after the installation of new members of the Board of Directors.

n8 The Simon court said: "Our reading of the District Court's Order indicates that the Court's discussion of the reasonableness of Simon's reliance and his access to inside information was properly directed to the commonality of issues between him and the purported class." **[*14]**

The significant differences between Saxon's facts and this case are twofold. In this case, there is no evidence that Melzer's contacts gave her any information not already available to the public, whereas in Saxon, there was evidence to that effect. Second, the substance of the conversation Mr. Salmanson had with the Saxon corporate officers was in evidence, whereas the substance of the conversation between Mr. Melzer and Defendant Donald is not in evidence.

In Zandman v. Joseph, 102 F.R.D. 924, 930 (N.D. Ind. 1984), the plaintiff had spoken with the company's security analysts, had attended special meetings for securities analysts, and had a three million dollar investment in the company. Zandman is therefore distinguishable on its facts, since neither Melzer nor McFarlane's minimal contacts were formed on a basis of such investor strength.

Measured against these cases, Melzer's and McFarlane's contacts do not constitute "unique access."

B. Sophistication -- Feder.

Defendants argue that Feder, because of his sophistication, is atypical.

Feder is an attorney, earning the vast majority of his income from his law practice. (Dep. 46-48.) n9 He works on his investments **[*15]** about 30 minutes per week and invests only for his professional corporation and his wife. (Dep. 31.) He reads investment publications, (Dep. 82.) speaks to his broker regularly, (Dep. 30.) and uses an Apple spreadsheet computer program to calculate his net worth. (Dep. 101.)

n9 The exact portion of Feder's income derived from securities transactions was designated as confidential.

The question is whether under Warren v. Reserve Fund Inc., 728 F.2d 741, 747 (5th Cir. 1984), Feder should be considered "sophisticated." In Warren, the proposed class representative was a licensed securities broker, a vice-president of a bank, and worked daily with yields and calculations of yields on investment securities.

That Feder spends little time on his investments, earns only a small portion of his income from investments, and invests for only two people controls this issue. Feder is not sophisticated under Warren.

C. Reliance -- Salit Teichler and Olson.

Defendants argue that Salit, Teichler, and Olson cannot serve as class representatives because they cannot prove reliance.

Defendants must shoulder the burden to rebut the presumption of reliance. Blackie, 524 F.2d at 906. **[*16]** Until Defendants do so, Salit, Teichler, and Olson need not present positive proof of their reliance.

Further, with regard to Salit, Defendants argue that he cannot fairly represent the class because he neither relied on the alleged misrepresentations nor on the integrity of the market place; rather he allegedly relied on a friend's advice. Defendants' assertion that Salit relied on the advice of a DSC salesman, a Mr. Onorata, contradicts the only testimony submitted. Salit testified that he did not rely on information given him by Mr. Onorata and that he relied upon the integrity of the marketplace. (Dep. 25.)

D. Due Diligence -- Teichler and Olson.

Defendants argue that Teichler and Olson cannot serve as class representatives because they cannot prove "due diligence."

The relevant inquiry in determining due diligence is whether the plaintiff has "intentionally refused to investigate in disregard of a risk known to him or so obvious that he must be taken to have been aware of it, and so great as to make it highly probable that harm would follow." Stephenson v. Paine Webber Jackson & Curtis, No. 86-3515, slip op. at 2314 (5th Cir. March 16, 1988).

Defendants ignore this standard. **[*17]** They argue, without citing cases, that Teichler and Olson must prove a higher level of diligence than other people, because of their work experience and training. Teichler is a semi-retired CPA who worked for the IRS for nearly 30 years and spent 20 of those years auditing corporate tax returns. Olson is a self-employed marketing and business consultant in the field of consumer package goods. He earned an MBA from Cornell.

Because Defendants failed to address the relevant inquiry, they have failed to show that Teichler and Olson are inadequate as class representatives for lack of due diligence.

E. Trading History -- Olson.

The last objection that Defendants raise to Olson's participation as a class representative is that his stock trading history is atypical. They argue that whereas most of the proposed representatives appear to complain that DSC's misrepresentations made during the summer of 1984 caused them to buy stock, Olson sold stock during that time. The Court rejects this argument because Defendants have failed to support it and because this Court has found no authority to support it.

VI. Fairly and Adequately Protect the Class -- Olson.

Defendants raise an additional **[*18]** objection to Olson's role as a class representative, that he is ill-motivated.

Defendants argue that Olson is suspect, because he initiated his class action claim after he

knew another lawsuit had been filed. Defendants quote Olson as testifying that he became a named plaintiff because he thought doing so would give his interests "greater consideration." n10

n10 Brief in Opposition to Motion for Class Certification at 46-47.

Two flaws mar Defendants' argument. First, Defendants selectively quote Olson's testimony. A more representative portion of Olson's testimony follows:

Q: (BY MR. GRAVES): Did [Olson's lawyer] explain to you what the advantages were, disadvantages would be in appearing in the lawsuit as a named party as opposed to remaining as an unnamed member of the class?

A: Only in the sense that as a named party, I would have an opportunity to participate and perhaps a judgment would be -- would take my interests into greater consideration. I don't mean that in a financial sense.

Q: You say participate. What do you mean? You said it gave you a greater opportunity to participate.

A: To take an active role to insure that the -- that-- that my, if you will, my issues **[*19]** or my -- my claim would be fully heard.

The second flaw in Defendants' argument is that they failed to show the significance, if any, to Olson's "motive." The motive of a proposed class representative may or may not affect the adequacy of representation, depending on whether it results in an irreconcilable conflict. 4 Newberq on Class Actions § 22.24 (1985). Absent a showing of material conflict with the class, litigiousness is not a ground to find inadequacy as a class representative. Id.

VII. Pendent State Claims.

Defendants argue that Plaintiffs' pendent state claims are inappropriate for class action treatment. They reason that because the plaintiffs come from various states other than Texas, the Court could not efficiently resolve pendent state claims on the law of the other states.

Defendants' argument fails because it assumes that this Court must resolve the pendent state claims on the law of other states. The Court must apply the choice of law rules of Texas. Klaxon Co. v, Stentor Electric Manufacturing Co,, 313 U.S. 487, 497 (1941). Whether in contract or in tort, Texas law applies the most significant relationship test n11 given in Restatement (Second) of **[*20]** Conflicts of Law § 6 (1971). Duncan v. Cessna Aircraft Co., 665 S.W.2d 414, 421 (Tex. 1984); Gutierrez v. Collins, 583 S.W.2d 312, 318 (Tex. 1979). Under this test, the Court would not necessarily apply the laws of other states.

n11 Section 6 Choice-of-Law Principles

(1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.

(2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include

(a) the needs of the interstate and international systems,

(b) the relevant policies of the forum,

(c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,

(d) the protection of justified expectations,

(e) the basic policies underlying the particular field of law,

(f) certainty, predictability and uniformity of result, and

(g) ease in the determination and application of the law to be applied.

VIII. Conclusion.

Having held a hearing and considered the arguments and evidence presented by the parties, the Court finds that common questions of law and fact will predominate in this **[*21]** case. The Court further finds that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. Therefore, the Court conditionally certifies the proposed class pursuant to Rule 23 (c)(1).

The parties shall attempt to agree upon a proposed notice for submission to the Court in the form recommended in the Manual for Complex Litigation § 30.21. If the parties cannot agree upon a proposed notice, then each party may submit a proposed notice. All proposed notices must be filed within thirty days from the date of this Order.